STATE OF ALABAMA
DEPARTMENT OF INSURANCE
MONTGOMERY, ALABAMA

REPORT OF EXAMINATION OF

SOUTHERN UNITED FIRE INSURANCE COMPANY

MOBILE, ALABAMA

AS OF DECEMBER 31, 2006

PARTICIPATION:
SOUTHEASTERN ZONE, NAIC
ALABAMA

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STATE OF ALABAMA
COUNTY OF MOBILE

I, Palmer W. Nelson, being first duly sworn, upon his oath deposes and says:

That he is an examiner appointed by the Commissioner of Insurance for the State of Alabama;

That an examination was made of the affairs and financial condition of Southern United Fire Insurance Company for the period July 1, 2002 through December 31, 2006;

That the following 45 pages constitute the report thereon to the Commissioner of Insurance of the State of Alabama;

And that the statements, exhibits and data therein contained are true and correct to the best of his knowledge and belief.

____
Palmer W. Nelson, CFE

Subscribed and sworn to before the undersigned authority this 1st day of April, 2008.

____
(Signature of Notary Public)

Beth Mason, Notary Public
(Print Name)

in and for the State of Alabama.

My commission expires NOTARY PUBLIC STATE OF ALABAMA AT LARGE
MY COMMISSION EXPIRES: Mar 15, 2009
[illegible] PUBLIC UNDERWRITERS

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Mobile, Alabama
April 1, 2008

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Honorable Walter A. Bell, Commissioner
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Dear Commissioners and Directors:

Pursuant to your instructions and in compliance with the statutory requirements of the State of Alabama and the resolutions adopted by the National Association of Insurance Commissioners, an examination has been made of the affairs and condition of

Southern United Fire Insurance Company
Mobile, Alabama

as of December 31, 2006, at its home office located at One Southern Way, Mobile, Alabama 36619. The report of examination appears herewith.

Where the term "Company" appears herein without qualification, it will be understood to indicate Southern United Fire Insurance Company.

SCOPE OF EXAMINATION

A full scope examination was authorized pursuant to the instructions of the Alabama Insurance Commissioner and in accordance with the statutory requirements of the Alabama Insurance Code and the regulations and bulletins of the Alabama Department of Insurance; in accordance with the applicable guidelines and procedures promulgated by the National Association of Insurance Commissioners (NAIC); and in accordance with generally accepted examination standards.

The Company was last examined for the four and one half year period ended June 30, 2002. The current examination covers the intervening period from July 1, 2002 through December 31, 2006, and was conducted by examiners from the Alabama Department of Insurance representing the NAIC's Southeastern Zone. Where deemed appropriate, transactions subsequent to December 31, 2006, were reviewed.

The examination included a general review of the Company's operations, administrative practices, and compliance with statutes and regulations. Corporate records were inspected. Income and disbursement items for selected periods were tested. Assets were verified and valued, and all known liabilities were established or estimated as of December 31, 2006, as shown in the financial statements contained herein. However, the discussion of assets and liabilities contained in this report has been confined to those items which resulted in a change to the financial statements, or which indicated a violation of the Alabama Insurance Code, the Insurance Department's rules and regulations, or statutory accounting principles which were deemed to require comments and/or recommendations.

A signed certificate of representation was obtained during the course of the examination. In the certificate, management attests to have valid title to all assets and to the nonexistence of unrecorded liabilities as of December 31, 2006. A signed letter of representation was also obtained at the conclusion of the examination whereby management represented that, through April 1, 2008, complete disclosure was made to the examiners regarding asset and liability valuation, financial position of the Company, and contingent liabilities. An office copy of the Company's filed Annual Statement as of December 31, 2006, was compared with or reconciled to account balances with respect to ledger items. The Company's accounts were examined by KPMG, Birmingham, Alabama, certified public accountants (CPAs) for each year under examination. The examiners utilized some of the CPAs workpapers in conjunction with the examiners' test work to complete some of the audit procedures in instances in which the examiners determined that it was appropriate.

The market conduct review consisted of a review of the Company's plan of operation, territory, policy forms and underwriting practices, advertising and marketing, claims, policyholder complaints, agents' licensing practices, and compliance with privacy standards.

ORGANIZATION AND HISTORY

The Company was incorporated on May 14, 1963, under the laws of the State of Alabama and began operations on October 28, 1963, with $100,000 capital and $100,000 paid in surplus provided from the sale of 100,000 shares of $1 par value common stock for a price of $2 per share. From the time of incorporation until 1986, the Company was a wholly owned subsidiary of Southern United Life Insurance Company (SULIC), Montgomery, Alabama. In 1986, SULIC was obtained by Mutual Savings Life Insurance Company (MSLIC), and relocated to Decatur, Alabama. In April of 1989, the Company was purchased by Southern United Holding Company, Inc. (SUH) and moved to Mobile, Alabama. Prior to the sale, most of the Company's business was assumed by Mutual Savings Fire Insurance Company, a subsidiary of MSLIC. In January 1998, Kingsway Financial Services, Inc., Mississauga, Ontario, Canada, through Kingsway of America, Inc., (Kingsway) acquired SUH, the Company's parent. Approval of the transaction was given by the Alabama Department of Insurance on January 16, 1998.

During 1998, the Company established a wholly owned subsidiary, Southern United General Agency of Texas, Inc.

SUH and the Company are presently based in Mobile, Alabama, and are engaged in the sale of property and casualty insurance products throughout the Southeastern United States.

No amendments to the Company's Articles of Incorporation or By-Laws were made during the period under examination.

Southern United Holding requested approval from the Alabama Department of Insurance for forgiveness of any and all indebtedness of the Company, as it relates to three separate surplus notes held by Southern United Holding, Inc. Two of the surplus notes, one for $700,000 and the other for $1,925,000, were filed and approved by the Alabama Department of Insurance on December 30, 1996. The third surplus note for $296,250 originated in 1991 and was amended and restated with the Alabama Department of Insurance's approval on December 30, 1996. The Alabama Department of Insurance Commissioner approved the forgiveness of the surplus notes on April 10, 2006.

Capital changes since the Company's incorporation were as follows:

July 9, 1979	Amendment increased the par value of the common shares from $1 to $5 per share. Paid up capital was thereby increased to $500,000, represented by 100,000 shares authorized, issued and outstanding;
June 30, 1994	Amendment increased the par value of the common shares from $5 to $15 per share. Paid up capital was thereby increased to $1,500,000, represented by 100,000 shares authorized issued and outstanding;
December 30, 1996	A $296,250 surplus note, which was originally issued on December 31, 1991, was restated and approved by the Alabama Department of Insurance;
December 30, 1996	Two surplus notes, totaling $2,625,000, were approved by the Alabama Department of Insurance;

December 31, 1997	SUH contributed $3,875,000 additional paid in capital, thereby increasing Gross paid in and contributed surplus to $5,071,200 at year end 1997;
December 31, 1998	SUH contributed $3,995,000 additional paid in capital, thereby increasing Gross paid in and contributed surplus to $9,066,200 at year end 1998;
December 31, 2000	SUH contributed $700,000 additional paid in capital, thereby increasing Gross paid in and contributed surplus to $9,766,200 at year end 2000;
June 12, 2001	Kingsway contributed $1,500,000 additional paid in capital, thereby increasing Gross paid in and contributed surplus to $11,266,200;
July 20, 2001	Kingsway contributed $2,000,000 additional paid in capital, thereby increasing Gross paid in and contributed surplus to $13,266,200;
December 21, 2001	Kingsway contributed $1,000,000 additional paid in capital, thereby increasing Gross paid in and contributed surplus to $14,266,200 at year end 2001;
May 5, 2002	SUH contributed $1,000,000 additional paid in capital, thereby increasing Gross paid in and contributed surplus to $15,266,200;
May 31, 2002	Kingsway contributed $2,000,000 additional paid in capital, thereby increasing Gross paid in and contributed surplus to $17,266,200;
June 5, 2002	Kingsway contributed $2,000,000 additional paid in capital, thereby increasing Gross paid in and contributed surplus to $19,266,200;
June 28, 2002	SUH contributed $1,000,000 additional paid in capital, thereby increasing Gross paid in and contributed surplus to $20,266,200 at year end 2002;
October 31, 2002	Kingsway contributed $4,000,000 additional paid in capital, thereby increasing Gross paid in and contributed surplus to $24,266,200;
December 24, 2002	Kingsway contributed $3,750,000 additional paid in capital, thereby increasing Gross paid in and contributed surplus to $28,016,200 at year end 2002;
February 5, 2003 February 5, 2003 February 24, 2003	Kingsway contributed $800,000, $200,000, and $2,000,000 respectively. Gross paid in and contributed surplus thereby increased to $31,016,200;

June 30, 2003	Kingsway contributed $5,000,000 additional paid in capital, thereby increasing Gross paid in and contributed surplus to $36,016,200;
November 12, 2003	Kingsway contributed $300,000 additional paid in capital, thereby increasing Gross paid in and contributed surplus to $36,316,200;
April 25, 2006	SUH forgave surplus notes due of $2,921,250, thereby increasing Gross paid in and contributed surplus to $39,237,450.

The Company's capital structure reported in its 2006 Annual Statement was Common capital stock of $1,500,000, Gross paid in and contributed surplus of $39,237,450, and Unassigned funds of $(26,052,979).

MANAGEMENT AND CONTROL

Stockholders

At December 31, 2006, the Company's issued and outstanding stock was 100% owned by Southern United Holding, Inc. (SUH), an Alabama Corporation. SUH is a subsidiary of Kingsway Financial Services, Inc., a Canadian corporation.

Board of Directors

The Company's By-Laws mandate that its business shall be managed and controlled by a Board of Directors who shall be elected by the stockholders. The number of directors shall be no less than three, and no more than fifteen.

The following directors were elected by the Stockholder and were serving at December 31, 2006 (*resigned 2007).

Name/Residence	Principal Occupation
Richard Day Murray* Mobile, Alabama	President and CEO, Southern United Fire Insurance Company
William Gabriel Star* Mississauga, Ontario, Canada	President and CEO, Kingsway Financial Services, Inc.
William Shaun Jackson Oakville, Ontario, Canada	Executive Vice President and CFO, Kingsway Financial Services, Inc.
Charles Dixie Jordan Montgomery, Alabama	Retired
John Thomas Clark Naperville, IL	Vice President, Kingsway America, Inc. President and CEO, Lincoln General Insurance Company

Committees

At the July 22, 2004 meeting, the Board resolved to create three committees: Investment Committee, Reinsurance Committee, and Audit Committee. However, there were no committee meetings held during the exam period.

Officers

The Company's By-Laws provide that its executive officers shall be a President, a Vice President, a Secretary, and a Treasurer, each of whom shall be elected by the Board of Directors, and shall hold office until his or her successor has been duly elected and qualified, or until his or her death, or until he or she shall resign, or until removed by the Board. Other officers may be appointed as deemed necessary by the Board, and more than one office may be occupied by the same person. Officers appointed at the April 25, 2006, Board of Directors meeting, and serving at December 31, 2006, were as follows:

Officer	Title
Richard Day Murray*	President
Richard Wesley Bird*	Vice President and Secretary
Carrie Renee Harper	Treasurer

*Resigned April 24, 2007

Management and Service Agreements

During the examination period, the Company had a management and services agreement with Consolidated Insurance Management Corporation (CIMC), an affiliate. CIMC was dissolved December 31, 2004. Prior to the dissolution, CIMC was experiencing cash flow difficulties and management of the Company paid management and services fees to the affiliate in advance according to the Company's CFO. The advance payments for services were not in accordance with the management and services agreement that had been filed with and approved by the Alabama Department of Insurance. Subsequent to the dissolution of CIMC, the Company wrote off a balance of $2,765,797 due from the successor of CIMC March 31, 2005.

Management and Services and Facilities Agreement with Kingsway America, Inc.

The Company entered into an agreement with Kingsway America, Inc. for management services effective January 1, 2005 through December 31, 2007.

Under the agreement, Kingsway America, Inc. agreed to provide the following services and facilities:

- Accounting, tax reporting, and treasury management services including payroll, cash management, general accounting, financial reporting and the preparation and filing of tax reports

- Human resource services including employee relations, compensation, benefit design, administrative training, recruitment and organizational development
- Marketing services including information on customers, prospective customers and the state of the insurance marketplace as well as support services such as research, website creation and maintenance, and database marketing support
- Planning and budgeting services including the preparation of strategic business plans and expense budgets, and the completion of other planning-related activities
- Legal services including the review and drafting of agreements, and advice on regulatory and other requirements
- Services for developing a sound insurance program for the protection of the Company's assets including recommending such a program, and unless the Company directs otherwise, the placing of insurance through agencies and in companies chosen by Kingsway America, Inc.
- Internal audit services including claims, underwriting, systems, accounting and other financial reviews
- Information technology services including technology consulting services, application development and support services, data center management and production services, network management for both voice and data and other information technology related services as deemed necessary
- Other services as shall be agreed upon by the parties from time to time.

The Company agreed to pay the following fees for the services provided to it. The Company shall pay Kingsway America a fee for services, which shall be equal to 100% of the cost of providing such services and shall not include any amount for profit. A projection of anticipated services shall be prepared by Kingsway America at the beginning of each calendar quarter and the Company will pay monthly based on the estimate prepared. Within thirty days after the end of each calendar quarter, Kingsway will compare the total fees collected over the course of the year with the costs of providing those services actually rendered. Any overage shall be returned to the Company and any shortage billed.

Claims Servicing Agreement with Universal Casualty Company

The Company entered into an agreement with Universal Casualty Company (UCC) whereby the Company agreed to serve as the administrator for liability and physical damage insurance written under the private passenger automobile program underwritten by UCC. The agreement became effective August 1, 2004, and terminated on January 1, 2006. The termination agreement requires the Company to handle the claims received prior to the termination date until the claims are disposed of.

The Company agreed to provide the following claim management services for UCC:

- Investigate liability, damages and coverage; evaluate and negotiate claims through settlement or final disposition, and issue all claim payments with funds provided by the client. All payments were to be documented and supported with frequent reconciliations by traditional accounting methods performed

- Coordinate, direct and manage litigation activity including assigning defense to approved legal counsel subject to the client's control. Client will have ultimate control of all legal decisions and retain the right to handle and direct any litigation at any time
- Establish initial reserves and adjust them accordingly for potential exposure, considering value and liability. Initial reserves were to be based on the average experience of specific loss types/coverages. The administrator will have no settlement authority or reserve authority in excess of the limit of liability on the insurance policy which is triggered by the claim. Client specifically reserves the right to suspend settlement and/or reserve authority on all claim and litigation matters. Client reserves the right to set reserves, including initial reserves
- Coordinate all outside field assignments, investigations, appraisals, and experts, based on need, cost-effectiveness and return on expense/cost
- Manage, direct and coordinate claim file and operational audits or direct repair facilities, and perform regular evaluations of cost containment and other cost control measures
- Coordinate and handle all subrogation and salvage, disposal activities based on applicable state title statutes and regulations and applying recoveries and tracking transactions
- Address all complaints, including regulatory inquiries; maintain a log recording them, including whether such is justified, and the resolution and steps taken to address the issues.

UCC agreed to the following:

- Honor the payment of all covered claims as well as a service fee based on 5% of the premium earned each month in the State of Louisiana. The fee will cover all services provided by the administrator other than fees for external services described as: (a) Attorney fees, recovery and defense costs; (b) Subrogation recovery legal expense/court costs; (c) Experts (external cause & origin and reconstruction) – prior approval required; (d) Audits – external – performed by client; (e) Special management systems/data reports exceeding those in the agreement; (f) Other as agreed between the client and administrator
- Provide up-to-date information on any changes in excess insurance, limits of coverage, self-insured retention, or any changes that may affect its capacity to fulfill financial obligations to the administrator or as required to the public
- Cooperate fully in the disposition of the claims, including but not limited to, providing the administrator with policy limits settlement authority per liability claim and actual cash value for comprehensive, collision and property damages claims up to the limit of coverage
- Provide the administrator with 30 days advance written notice of any potential changes which might impact the administrator's financial capacity to deliver proper service, handle claims promptly, and to honor agreed settlement with any party to a loss, vendors or providers within the limits of the policy.

On January 1, 2006, the Company agreed to terminate the Claims Service Agreement with UCC with the following stipulations:

- All claims as of December 31, 2005, will be handled to completion by the Company
- In consideration of the Company handling the claims being processed to completion, UCC agreed to pay the Company a total of $60,000.

Guaranty Agreement

The Company entered into a Guaranty Agreement guaranteeing the performance of Southern United General Agency of Texas, Inc. (SUGAT), the Managing General Agent of Old American County Mutual Fire Insurance Company (Old American). The effective date of the agreement was January 1, 2005. SUGAT is a wholly owned subsidiary of the Company and the Company assumes 100% of the direct business of Old American.

The significant obligations of the Company under the agreement are the following. The Company guarantees the performance on any and all obligations of SUGAT under the Managing General Agency Agreement that SUGAT has with Old American including, without limitation, the payment of all funds owed to Old American, insureds, finance companies, claimants, or agents by SUGAT and all of SUGAT's balances arising pursuant to the Managing General Agency Agreement. The guaranty expressly includes any reasonable attorneys' fees and expenses incurred by Old American due to the failure of SUGAT to satisfy any obligation. The term of the guaranty agreement shall continue in effect until all obligations of SUGAT are satisfied.

Tax Allocation Agreement

The tax allocation agreement in effect at December 31, 2006, provides that the federal income taxes will be allocated among the parties on the basis of the actual tax liability. Net operating losses will be contributed to the consolidated tax filing. Participating entities providing a tax benefit due to contributed losses or tax credits will be compensated in the amount of the tax benefit provided to the consolidated filing. Including the Company, there were 25 subsidiary companies of Kingsway U. S. Finance Partnership participating in the consolidated filing.

The examination indicated that balances due to the Company from Kingsway U. S. Finance Partnership, as a result of losses or tax credits contributed by the Company to the consolidated federal income tax filing, were not settled within thirty days in accordance with the Tax Allocation Agreement. Further discussion of the issue is included in this report under the caption, "NOTES TO FINANCIAL STATEMENTS."

Conflicts of Interest

The Company's Employee Handbook requires directors, officers and employees to avoid actual or apparent conflicts of interests, and to disclose any conflicts that arise. The Company ensures compliance with its conflict of interest policies by requiring its directors, officers, and employees to complete and sign conflict of interest questionnaires on an annual basis. Beginning in 2006, these statements were filed electronically via the Company's electronic Code of Business Conduct and Ethics Acknowledgement process. Conflict of interest statements were filed by all directors and officers each year for the period under examination with the following exceptions. Director, Charles Jordan, did not file a statement in 2006, and in 2004 he filed an incomplete statement, that while signed and dated, did not include any responses to the questions. No conflicts were disclosed for the period under examination by any officers or directors.

CORPORATE RECORDS

The Company's Articles of Incorporation and By-Laws were inspected during the course of the examination and the documents appeared to provide for the operation of the Company in accordance with usual corporate practices and applicable statutes and regulations.

Minutes of the Stockholder and Board of Directors meetings that took place during the examination period were reviewed. The minutes appeared to be complete and to adequately document the actions of the respective governing bodies.

The Company only performed criminal background checks on employees within the marketing department and managers in financial positions at the time they were hired. The Company does not require its producers, agencies, or subcontractors to attest to the fact that they have not been convicted of a felony involving dishonesty or a breach of trust. Section 1033 of Title 18 of the United States Code prohibits a person who has been convicted of a felony involving dishonesty or a breach of trust from willfully engaging in the business of insurance that affects interstate commerce unless the prohibited person has obtained permission from the Commissioner. ALA. ADMIN. CODE 482-1-121(2002) elaborates on the definition of a prohibited person under Section 1033 of Title 18 of the United States Code. Prohibited persons may be employees, producers, insurance agencies, consultants, third party administrators, or MGAs of the Company or subcontractors of the Company or of an agency of the Company who have been convicted of a felony involving dishonesty or a breach of trust unless the Commissioner permits it. The Company's action was not satisfactory to ensure that none of the employees were prohibited persons.

HOLDING COMPANY AND AFFILIATE MATTERS

The Company is subject to the Alabama Insurance Company Regulatory Act of 1973 as defined in ALA. CODE §27-29-1(1975). The review of the filings made during the examination period indicated that appropriate disclosures were made. However, amendments to reinsurance contracts with affiliates require a prior notification to the Commissioner. The Company did not make the required notifications to the Alabama Department of Insurance.

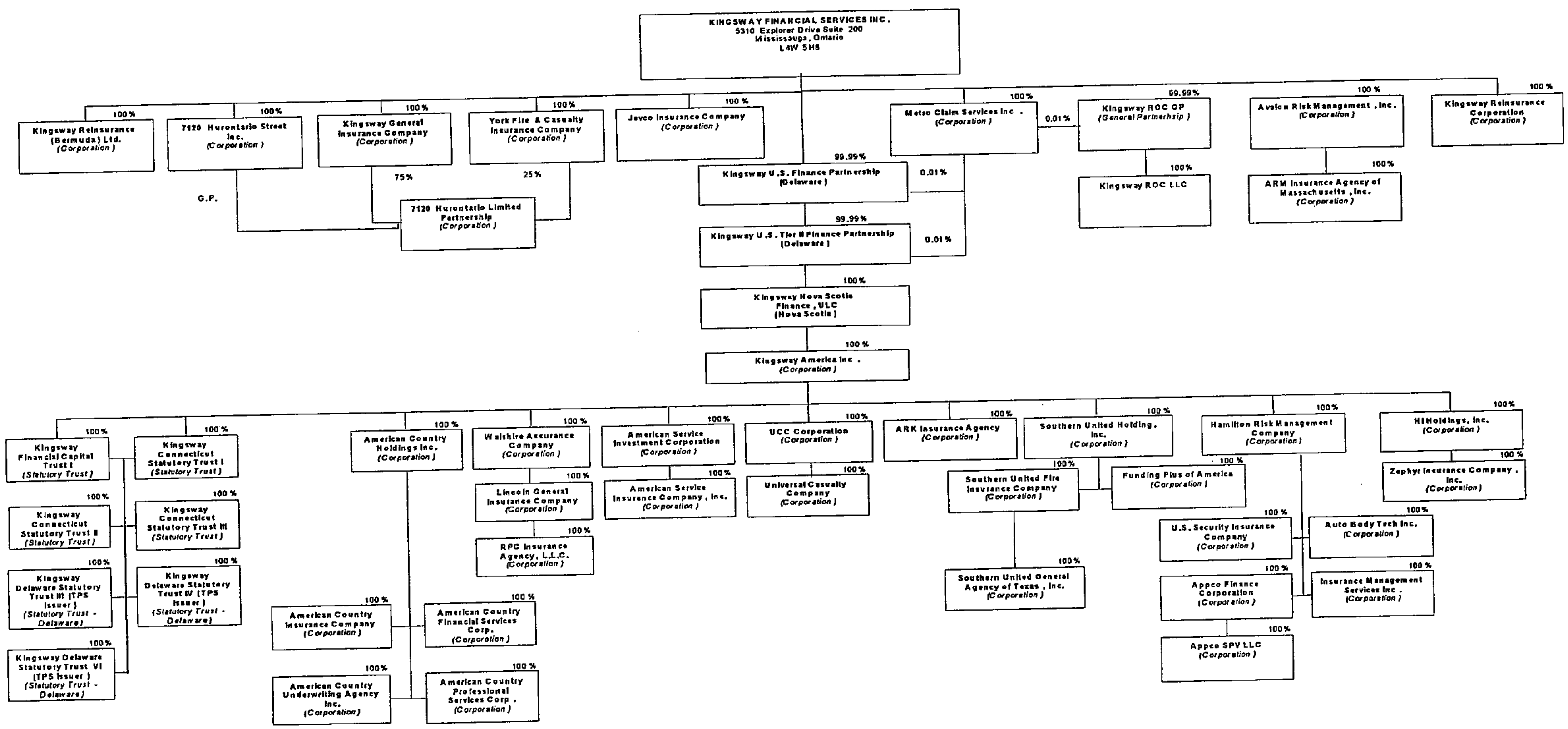
Dividends to Stockholders

There were no stockholder dividends paid by the Company during the examination period.

Organizational Chart

The organizational chart on the following page depicts the insurance holding company system with which the Company was affiliated as of December 31, 2006.

Southern United Fire Insurance Company
Organizational Chart
December 31, 2006



FIDELITY BONDS AND OTHER INSURANCE

At December 31, 2006, the Company was a named insured under a policy providing employee dishonesty, on premises, in transit, forgery and alteration, extended forgery, counterfeit money, and computer system coverage issued by Chubb Group of Insurance Companies. The amount of fidelity coverage provided by the policy exceeded the minimum amount suggested by the NAIC.

In addition to the above coverage, the Company was insured by the following types of coverage:

Commercial General Liability
Commercial Property Insurance
Employer's Liability
Commercial Automobile Liability
Employee Benefits Liability
Stop Gap Coverage
Workers' Compensation Insurance

The types of coverages and limits appear to have adequately covered the Company from material exposures.

EMPLOYEE AND AGENT WELFARE

At December 31, 2006, benefits provided by the Company to its employees included the following:

Paid holidays and vacation,
Personal leave
Family Medical Leave Act leave
Disability leave
Military leave
Bereavement leave
Jury duty leave
401(k) deferred compensation plan
Employee share purchase plan
Medical and dental insurance
Accidental death and dismemberment insurance
Long term disability insurance
Financial assistance for tuition reimbursement
Flexible spending plan

An incentive plan was available that awarded executive management bonuses based on performance.

STATUTORY DEPOSITS

At December 31, 2006, as required or permitted by law, the Company maintained deposits with the respective statutory authorities as follows:

State	Statement Value	Market Value
Alabama	$2,740,418	$2,720,519
Georgia	$85,000	$85,000
Louisiana	$70,000	$70,000
South Carolina	$2,109,788	$2,109,788

FINANCIAL CONDITION/GROWTH OF COMPANY

	2006*	2005	2004	2003	2002
Admitted Assets	$25,156,942	$30,062,562	$34,109,192	$34,007,096	$44,115,690
Liabilities	12,091,908	9,482,250	12,669,126	14,888,236	30,331,876
Common Capital Stock	1,500,000	1,500,000	1,500,000	1,500,000	1,500,000
Paid in and Contributed Surplus	39,237,450	36,316,200	36,316,200	36,316,200	31,016,200
Unassigned Funds	(27,672,417)	(20,157,138)	(19,297,384)	(21,618,592)	(21,653,636)
Gross Written Premium	28,134,029	24,610,188	41,444,835	66,517,073	73,790,836

*Per Examination

MARKET CONDUCT ACTIVITIES

Plan of Operation

During the examination period, the Company wrote private passenger automobile liability and physical damage insurance in the nonstandard market. In 2007, the Company began writing commercial automobile. The commercial automobile program is managed by American Country Insurance Company. In 2008, the Company plans to write wind peril coverage which will be managed entirely by Lincoln General Insurance and will be ceded to a non-affiliated reinsurer under a quota share treaty 95% pro rata.

Territory

At the examination date, the Company was licensed to transact business in the following seven states:

Alabama	Georgia	Kansas	Louisiana
Mississippi	South Carolina	Texas	

The Certificates of Authority for the respective jurisdictions were inspected for the period under review and found to be in order. Authorized lines were compared with the lines of business shown in the Underwriting and Investment Exhibits of the 2006 Annual Statement, and no discrepancies were noted.

Policy Forms and Underwriting

Policy Forms

The Company wrote six-month and twelve-month non-standard private passenger automobile liability and physical damage insurance policies for vehicles valued up to $50,000, and for drivers with up to 15 violation points. Liability limits up to $100,000/$300,000 for Bodily Injury and $50,000 for Property Damage, and deductibles up to $1,000 for Comprehensive and Collision coverage were available. The Company collected a policy fee for Alabama policies issued or renewed.

A sample of 100 policies was selected for review from a population of 118,499 new policies issued. The sample was reviewed to determine whether the rates charged for the policy coverages were in accordance with filed rates, and whether the policy forms and endorsements had been filed, and if the rating rules were properly utilized. It was determined that the Company was in compliance with ALA. ADMIN. CODE 482-1-123.04(b)(2002), which requires, "... all rates and forms filings for the personal lines of property and casualty insurance shall be according to the Prior Approval System."

Underwriting Practices

A review of the Company's underwriting practices included a review of the underwriting guidelines, declination and cancellation procedures as described by the Company's management. The information was reviewed to determine whether unfairly discriminatory practices were being used and if the Company consistently applied its guidelines to rejected and accepted business.

A review of the rejections/declinations could not be performed because the Company does not reject or decline applications. Independent agents were directed to not submit applications for applicants that did not meet the Company's underwriting criteria. It was the Company's practice to accept all applications submitted by appointed agents. The agent bound coverage before submitting the application to the Company's home office. If the policy application did not meet the Company's underwriting criteria, the policy was cancelled thirty days after it was issued.

A sample of fifty cancellations initiated by the Company and a sample of fifty insured requested cancellations were selected from a population of 210 cancellations. These samples were reviewed to determine the reasons for cancellations or non-renewals, to identify unfairly discriminatory practices, and to determine whether the Company provided advance notifications to consumers and complied with policy provisions and state laws. Generally, policies were cancelled due to non-payment of premiums or per the insureds' requests. If the Company non-renewed a policy, the decision was based on payment issues or was based on a valid underwriting decision.

Rates and Statistical Reporting

The Company is a member of ISO and utilized its symbol system with some modifications. The Company reports its writing and loss ratio annually to ISO, who reports it to the respective states.

Advertising and Marketing

The Company currently markets non-standard automobile insurance on a direct basis in all states in which it is licensed to do business, with the exception of Kansas and Texas. A small amount of motorcycle business is marketed and written in Alabama and South Carolina.

The Company does not have a formal advertising/marketing program. The Company employs marketing representatives to recruit agencies to write business. Promotional materials are used by the agencies for advertisement purposes. Agencies must get approval from Company management for any other advertising.

The Company has an internet site, www.southernunited.com, which indicates the physical location of the Company and its lines of business being sold in accordance with the standards from the NAIC Market Regulation Handbook. The internet site also locates agents for customers interested in the Company's insurance policies.

Claims Review

A sample of fifty paid and closed claims from a population of 4,855 and a sample of fifty denied claims from a population of 700 during the period under examination were reviewed. The examination of the samples indicated that the Company properly paid claims and/or denied the sampled claims in accordance with ALA. ADMIN. CODE 482-1-125(2002), which identifies standards for handling property and casualty insurance claims.

Policyholder Complaints

An inspection of the Company's complaint register was made by the examiners. The Company recorded 248 complaints in its complaint register during the examination period. A total of 74 complaints were received by the Alabama Department of Insurance.

A sample of fifty complaints was selected from the 248 complaints received by the Company during the examination period to determine whether the complaints were handled properly and responded to promptly. Upon request by the examiners, the Company was able to provide proper documentation to indicate that all complaints had been fully addressed.

It was determined that the Company did have a complaint manual in accordance with the standards of the NAIC Market Regulation Handbook, which requires the Company to have adequate complaint handling procedures. Also, the Company's internal complaint procedures were adequate in developing analysis of the complaints.

Compliance with Agents' Licensing Requirements

The examiners made an inspection of the Company's records to determine if agents representing the Company were properly licensed and appointed. The examiners compared the Company's 2006 listing of licensed and appointed agents to the Alabama Department of Insurance 2006 listing of agents appointed by the Company. The examiners also examined a sample of new business issued in Alabama to determine whether the agents that produced the business were properly licensed and appointed. The Alabama producers were properly licensed as required by ALA. CODE §27-7-30(a)(1975).

The examination indicated that the Company paid commissions to an unlicensed agent from the State of Louisiana. The amount of commissions for new business paid to the agent during the period that the agent was not licensed was $2,601.

The examiner also made an inspection of the Company's terminated producers' records to determine if individual termination notices from the Company to the producers and the Alabama Department of Insurance had been sent. The Company did not provide documentation that it had provided the required notices of terminations to sixteen of 47 terminated agents sampled and did not provide documentation of the required notices to terminate to the Alabama Department of Insurance for two of the 47 terminations sampled. The Company is required to send these notifications to the producer and the Alabama Department of Insurance in accordance with ALA. CODE §27-7-30.1(a)(1975), which requires that,

> Within 15 days after making the notification required by subsection (e) of Section 27-7-30, the insurer shall mail a copy of the notification to the producer at his or her last known address. If the producer is terminated for cause for any of the reasons listed in Section 27-7-19, the insurer shall provide a copy of the notification to the producer at his or her last known address by certified mail, return receipt requested, postage prepaid or by overnight delivery using a nationally recognized carrier.

And, ALA. CODE §27-7-30(e)(1975), which requires,

> Subject to the producer's contract rights, if any, an insurer or authorized representative of the insurer may terminate a producer's appointment at any time. An insurer or authorized representative of the insurer that terminates the appointment, employment, or contract with a producer for any reason shall within 30 days following the effective date of the termination, using a format prescribed by the commissioner, give notice of the termination to the commissioner.

Privacy Standards

The Company's Privacy Notice, which was first sent as a mass mailing to all Company policyholders in June of 2001, was reviewed for compliance with ALA. ADMIN. CODE 482-1-122(2002). The Company sent out the notices to new business policyholders when policies were written or renewed and annually thereafter beginning in June of 2001. The

Company provided notices to its customers that indicated the types of information collected, the way the information was to be used and the manner that it was to be collected. The notice also informed the customers that the Company did not disclose any information to any nonaffiliated third parties.

REINSURANCE

Ceded Reinsurance – Quota Share

The Company had a 75% quota share reinsurance agreement in effect during the examination period with Kingsway Reinsurance Corporation (KRe). The reinsurance agreement was effective July 1, 1999, and has been amended five times via endorsements. Under the agreement, the Company cedes 75% of its direct and assumed automobile business to KRe, classified as private passenger automobile, motorcycle and commercial automobile. KRe is an unauthorized reinsurer domiciled in Barbados. The agreement involves a sliding scale commission that slides based on the loss experience of the subject business. Initially, the Company receives a 31% provisional ceding commission. The ceding commission slides from a minimum of 20% at a 75% or higher loss ratio to a maximum of 36% at a 59% or lower loss ratio. The agreement indicates that the ceding commission slides at a one to one ratio, that is, every one percentage point reduction in the loss ratio from 75% increases the ceding commission one percentage point up to the stated maximum ceding commission.

The cessions made under the 75% quota share agreement are subject to the following limits:

- Personal liability, medical payments and watercraft liability on mobile home policies issued by the Company - $100,000
- Maximum private passenger automobile physical damage - $50,000
- Maximum commercial automobile physical damage - $120,000
- Maximum inland marine physical damage - $150,000.
- Ceded Reinsurance (add commentary for ceded quota share treaty between SUFI and Kingsway Reinsurance Corporation

The examiners' analysis of risk transfer in connection with the Company's quota share reinsurance agreement with Kingsway Reinsurance Corporation did not result in an opinion that risk transfer was present in the agreement at December 31, 2006. Company management did not agree with the examiners' finding. Due to changes that were made in the provisions for the ceding commissions, the quota share agreement shifted in the direction of involving risk transfer beginning with agreement year 2006. After recognizing significant premium rate decreases implemented by the Company and considering the risks associated with entering new classes of business, the examiners determined that the 2007 agreement year contained sufficient risk transfer to qualify for reinsurance accounting treatment. The reinsurance contract was amended for agreement year 2008 to eliminate the adjustable ceding commission feature of the agreement. The examiners determined that the quota share agreement qualified for reinsurance accounting treatment in 2008. In consideration of the contract provision changes in 2007 and 2008, a compromise was reached that did not involve prescribing deposit type accounting for 2006 and prior years. A part of the compromise reached was an agreement that the Company did not correctly evaluate the premium deficiency reserves in a manner consistent with their reinsurance treatment and that the adjustment of $962,223 for premium deficiency reserves was suitable. Therefore, the financial statements included in this report do not include any adjustments relating to deposit type accounting. For further discussion of the premium deficiency reserves, see Note 11 of the Notes to Financial Statements.

The letter of credit collateralizing reinsurance balances, in the amount of $19,186,000, as of December 31, 2006, was issued by four issuing banks, participating at various stipulated percentages. The Royal Bank of Canada, New York, New York was the letter of credit agent. The letter of credit was a clean irrevocable letter of credit. The original letter of credit was issued on October 4, 2002, and provided for automatic extensions of one year terms. Since that time, the letter of credit has been amended a number of times changing the issuing banks and the amount and term of the letter of credit. The review of the amendment of the letter of credit effective December 31, 2006, indicated that the amendment was dated February 20, 2007, and amended the amount of the letter of credit retroactively to the effective date of December 31, 2006. However, the letter of credit in effect prior to the amendment was adequate to collateralize the balances included in this report.

The Company has added five endorsements to its ceded quota share reinsurance agreement with Kingsway Reinsurance Corporation. The Company could not provide evidence of filing the required prior notification to the Commissioner of the Company's intentions to amend its reinsurance agreement with an affiliate for Endorsement No. 1. Furthermore, the Company filed the remaining notifications seeking retroactive approvals rather than making the required prior notifications. ALA. CODE §27-29-5(b)(1975) requires,

> The following transactions involving a domestic insurer and any person in its holding company system may not be entered into unless the insurer has notified the commissioner in writing of its intention to enter into such transaction at least thirty days prior thereto, or such shorter period as the commissioner may permit, and the commissioner has not disapproved it in that period... (3) Reinsurance agreements or modifications thereto in which the reinsurance premium or a change in the insurer's liabilities equals or exceeds five percent of the insurer's surplus as regards policyholders, as of the 31st day of December next preceding, including those agreements which may require as consideration the transfer of assets from an insurer to a nonaffiliated, if an agreement or understanding exists between the insurer and nonaffiliate that any portion of assets will be transferred to one or more affiliates of the insurer.

The Company combined all agreement years from July 1, 1999 through year-end 2004 into one agreement period for purposes of calculating the adjusted ceding commission. This accounting treatment resulted in a benefit to the affiliated reinsurer of approximately $3.0 million. Management of the Company and their reinsurer both stated that the accounting treatment was consistent with the intent of both parties to the contract, though it was admittedly not in compliance with the contract. The ceding commissions that were not calculated in accordance with the reinsurance agreement related to years prior to the examination period and up to year-end 2004.

Ceded Reinsurance – Property Catastrophe Excess of Loss

At December 31, 2006, the Company was a named insured under a consolidated group policy, entitled "Property Catastrophe Excess of Loss Reinsurance Agreement." The contract became effective July 1, 2006, for one year. The agreement indemnified the Company with respect to the in-force business classified as property and which accrued as a result of loss and losses occurring from any one event during the term of the agreement. The reinsurer will indemnify up to a limit of $3,000,000 of ultimate net loss in the aggregate in excess of $2,000,000.

Ceded Reinsurance – Excess Property Catastrophe

The Company was a named insured under an "Excess Property Catastrophe Reinsurance Agreement," effective July 1, 2006, for a one year term, which reinsured the Company for excess liability which may accrue under its policies, contracts and binders of insurance or reinsurance in force at the effective date resulting from any one event. The agreement involved multiple participating reinsurers and was provided through an intermediary, Aon Re, Inc. There were no terms that indicate how premiums and loss recoveries were to be allocated among the insured entities. During the examination period, premiums for the catastrophe coverage were allocated by an analysis that was prepared by Aon Re, Inc. of the benefit received by each entity. During the examination period, loss recoveries were shared on a basis equal to each respective entity's catastrophe losses stated as a percentage of the insureds' aggregate catastrophe losses in connection with the triggering catastrophe event. The ceding companies shall retain and be liable for the amount of ultimate net loss in respect of each excess layer.

	First Excess	Second Excess	Third Excess
Ceding Companies' Retention	$5,000,000	$10,000,000	$20,000,000
Reinsurer's Per Occurrence Limit	$5,000,000	$10,000,000	$5,000,000

Assumed Reinsurance

The Company entered into a reinsurance agreement with Old American County Mutual Fire Insurance Company (Old American) effective December 31, 2006, whereby the Company agreed to assume the cedant's business on a 100% quota share basis. The business is comprised of private passenger automobile insurance in the Texas nonstandard market. The assumption involved assuming all of the business in force as of the effective date with the reinsurer responsible for losses and loss adjustment expenses that were incurred on and after the effective date. The arrangement required the Company to record unearned premium reserves for all of the business in force on the effective date, but did not require the recording of reserves for losses or loss adjustment expenses as of the effective date, which is the same date as the examination date. The cedant's business is administered exclusively by Southern United General Agency of Texas, a wholly owned subsidiary of the Company.

ACCOUNTS AND RECORDS

The Company maintained its accounting, premiums and losses data electronically. When necessary, the Company prepared additional electronic workpapers and hard copy reconciliations and workpapers. Hard copy claim files were documented and retained. Additional electronic claim files and file notes were documented and retained. The complete claim files were comprised of a combination of electronic and hard copy records.

The Company began utilizing a third party administrator in Arizona to receive and process all incoming claims on July 16, 2007. The Company has been allowing the third party administrator to maintain the claim files at the third party administrator's offices in Arizona. ALA. CODE §27-27-29(a)(1975) states in part, "Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of insurance transacted."

While the examiners were reconciling the loss and loss adjustment expense payments to Schedule P, it was discovered that the 2005 adjusting and other loss adjustment expense payments did not reconcile to the Underwriting & Investment Exhibit - Part 3 loss adjustment expenses. The CFO responded to the examiner's inquiry to indicate that the Underwriting & Investment Exhibit was completed involving errors in which there was a misallocation of amounts between column 1 - Loss Adjustment Expenses and column 2 - Other Underwriting Expenses. The errors discovered were not material.

In reviewing the detail supporting the 2006 Annual Statement Underwriting and Investment Exhibit - Part 3 Expenses, it was noted that the Company erroneously included $704,399 of expenses relating to reinsurance assumed (line 2.2) with its reporting for direct expenses (line 2.1). These accounts should be reported separately in accordance with the NAIC Annual Statement Instructions. Even though this mistake was a material amount, this is a misclassification error and will have no effect on the total expenses paid by the Company.

The examination indicated that the Company did not have a formal records retention policy.

The Company has responded to the examiners' inquiries to indicate that it does not currently have a long term strategic plan, but is in the process of developing one.

The Company reported its management and information systems fees paid to affiliated entities during 2006 as a one-line expense item in the 2006 Underwriting & Investment Exhibit Part 3 Expenses. The NAIC Annual Statement Instructions state,

> A Company that pays any affiliated entity (including a managing general agent) for the management, administration, or service of all or part of its business or operations shall allocate these costs to the appropriate expense, classification items (salaries,

rent, postage, etc.) as if the costs had been borne directly by the company. Management, administration, or similar fees should not be reported as a one-line expense. The company may estimate these expense allocations based on a formula or other reasonable basis.

FINANCIAL STATEMENTS

The financial statements included in this report were prepared on the basis of the Company's records, and the valuations and determinations made during the examination for the year 2006. Amounts shown in the comparative statements for the years 2002, 2003, 2004, and 2005 were compiled from the Company's copies of the filed Annual Statements. The statements were presented in the following order:

Southern United Fire Insurance Company
Statement of Assets, Liabilities, Surplus and Other Funds
For the Year Ended December 31, 2006

Assets

	Assets	Non-admitted Assets	Net Admitted Assets
Bonds (Note 1)	$11,800,102	$	$11,800,102
Stocks: Common Stock (Note 2)	1,000	1,000	
Real Estate: Properties occupied by the Company	2,457,963		2,457,963
Real Estate: Properties held for the production of income	462,197	165,947	296,250
Cash, cash equivalents, and short-term investments (Note 3)	85,581		85,581
Investment income due and accrued	121,137		121,137
Premiums and considerations: Uncollected premiums and agents' balances in the course of collection (Note 3)	25,363	25,363	
Premiums and considerations: Deferred premiums, agents' balances and installments booked but deferred and not yet due (Note 4)	7,732,330	213,316	7,519,014
Reinsurance: Amounts recoverable from reinsurers	1,167,260		1,167,260
Reinsurance: Other amounts receivable under reinsurance contracts	617,114		617,114
Current federal and foreign income tax recoverable and interest thereon (Note 5)	552,213		552,213
Net deferred tax asset	2,640,192	2,640,192	
Guaranty funds receivable or on deposit	98,716	98,716	
Electronic data processing equipment and software (Note 6)	162,235		162,235
Furniture and equipment, including health care delivery assets	208,997	208,997	
Receivables from parent, subsidiaries and affiliates (Note 7)	378,073		378,073
Aggregate write-ins for other than invested assets	159,831	159,831	
Total Assets	$28,670,304	$3,513,362	$25,156,942

THE NOTES TO THE FINANCIAL STATEMENTS ARE AN INTEGRAL PART THEREOF.

Liabilities, Surplus, and Other Funds

Liabilities:	
Losses Note 8)	$2,904,014
Loss adjustment expenses **(Note 8)**	1,644,996
Commissions payables, contingent commissions and other similar changes **(Note 9)**	448,581
Other expenses **(Note 9)**	402,027
Taxes, licenses, and fees	366,863
Unearned Premiums	2,840,843
Advance premium **(Note 3)**	
Ceded reinsurance premiums payable **(Note 9)**	2,373,086
Amounts withheld or retained by the Company for the account of others **(Note 10)**	143,471
Provision for reinsurance	5,804
Premium deficiency reserves **(Note 11)**	962,223
Total Liabilities	$12,091,908
Surplus and Other Funds:	
Common capital stock	1,500,000
Gross paid in and contributed surplus	39,237,450
Unassigned funds **(Note 13)**	(27,672,417)
Surplus as regards policyholders	$13,065,033
Total Liabilities and Stockholders' Equity	$25,156,941

THE NOTES TO THE FINANCIAL STATEMENTS ARE AN INTEGRAL PART THEREOF.

Southern United Fire Insurance Company
Summary of Operations
For the Years Ended December 31, 2002, 2003, 2004, 2005, 2006

	2006	2005	2004	2003	2002
Underwriting Income					
Premiums earned	$5,774,516	$6,897,318	$11,648,044	$17,554,320	$18,219,417
Deductions					
Losses incurred	3,159,390	2,456,876	5,933,945	10,603,954	13,116,026
Loss expenses incurred	3,621,942	3,581,576	4,642,098	4,996,944	5,678,001
Other underwriting expenses Incurred	6,352,022	644,360	(1,326,498)	5,799,778	14,473,298
Aggregate write-ins for Underwriting deductions	1,443,144	2,765,797			
Total underwriting deductions	$14,576,498	$9,448,609	$9,249,545	$21,400,676	$33,267,325
Net underwriting gain / (loss)	$(8,801,982)	$(2,551,291)	$2,398,499	$(3,846,356)	$(15,047,908)
Investment Income					
Net investment income earned	886,730	842,800	775,860	765,968	740,337
Net realized capital gains / (loss)	(99,366)	(20,912)	8,588	105,301	13,199
Net investment gain / (loss)	787,364	821,888	784,448	871,269	753,536
Other Income					
Net gain/(loss) from agents' or premium balances charged off	(380,213)	(427,949)	(685,909)	(1,160,680)	(28,139)
Finance and service charges not included in premiums	893,961	773,439	966,556	1,213,090	1,292,693
Aggregate write-ins for miscellaneous income	19,145	15,462	28,399	59,206	69,049
Total other income	532,893	360,952	309,046	111,616	1,333,603
Net income, after dividends to policyholders, after capital gains tax and before all federal and foreign income tax	(7,481,725)	(1,368,451)	3,491,993	(2,863,471)	(12,960,769)
Federal and foreign income taxes incurred	(289,111)	(868,689)	1,071,270	(3,138,565)	(3,009,669)
Net Income	$(7,192,614)	$(499,762)	$2,420,723	$275,094	$(9,951,100)

THE NOTES TO THE FINANCIAL STATEMENTS ARE AN INTEGRAL PART THEREOF.

Southern United Fire Insurance Company
Capital and Surplus
For the Years Ended December 31, 2002, 2003, 2004, 2005, 2006

	2006	2005	2004	2003	2002
Surplus as regards policyholders, December 31 prior year	$20,580,312	$21,440,067	$19,118,860	$13,783,814	$7,451,403
Net income	(7,192,614)	(499,762)	2,420,723	275,094	(9,951,100)
Change in net unrealized capital gains or (losses)	45,520	(45,520)			
Change in net deferred income tax	1,824,674	(401,024)	(100,183)	(2,531,940)	1,168,821
Change in nonadmitted assets	(2,208,439)	46,683	(35,417)	2,261,029	(1,057,710)
Change in provision for reinsurance	15,580	39,868	36,084	30,863	(77,600)
Change in surplus notes (Note 12)	(2,921,250)				
Surplus adjustments: Paid in (Note 12)	2,921,250			5,300,000	16,250,000
Change in surplus as regards policyholders for the year	$(7,515,279)	$(859,755)	$2,321,207	$5,335,046	$6,332,411
Surplus as regards policyholders, December 31 current year	$13,065,033	$20,580,312	$21,440,067	$19,118,860	$13,783,814

THE NOTES TO THE FINANCIAL STATEMENTS ARE AN INTEGRAL PART THEREOF.

NOTES TO FINANCIAL STATEMENTS

Note 1 - Bonds **$11,800,102**

The above captioned amount is the same as reported by the Company in its 2006 Annual Statement.

Issue 1

The Company reviews prepayment assumptions of mortgage backed securities twice per year. SSAP No. 43, paragraph 11 states, in part, "Changes in currently estimated cash flows, including the effect of prepayment assumptions, on loan-backed securities shall be reviewed periodically. For securities that have the potential for loss of a portion of the original investment, the review shall be performed at least quarterly."

Issue 2

The Company did not amortize its bond identified by CUSIP No. 31401J-N9-5 correctly. During the course of the examination, the Company obtained a corrected amortization schedule for the bond from its investment manager. The carrying value of the bond per the corrected amortization schedule was $600 less than the carrying value of the bond reported by the Company in its 2006 Annual Statement Schedule D. The overstatement of the bonds in connection with this issue is not material and no adjustments were made in the financial statements included in this report.

Note 2 - Common Stocks **$ 0**

The above captioned amount is the same as reported by the Company in its 2006 Annual Statement.

The stock is comprised of an investment in a wholly owned subsidiary, Southern United General Agency of Texas (SUGAT). The Company did not value the investment in accordance with statutory accounting principles. Statutory accounting principles require that a subsidiary to be audited if the market valuation is not used. SUGAT was not audited and the investment does not meet the requirements for the market valuation approach to be used to value the investment. SSAP No. 88, paragraph 8b states in part,

> If a SCA investment does not meet the requirements for the market valuation approach in paragraph 8 a. or, if the requirements are met, but a reporting entity elects not to use that approach, the reporting entity's proportionate share of its investments in SCAs shall be recorded as follows... ii Investments in noninsurance SCA entities that are engaged in the following transactions or activities: ... (f) Providing insurance services on behalf of the reporting entity including but not limited to accounting, actuarial, auditing, data processing, underwriting, collection of premiums, payment of claims and benefits, policyowner services ... and if 20% or more of the SCA's revenue is generated from the reporting entity and its affiliates,

> then the underlying equity of the respective entity's audited Generally Accepted Accounting Principles (GAAP) financial statements shall be adjusted to a statutory basis of accounting...

Without audited financial statements on the subsidiary company, the examiners were unable to determine the true equity value of the Company's investment. SUGAT is potentially subject to future audit by the Alabama Department of Insurance in order to determine the true financial position of SUGAT and to determine the nature and extent of transactions occurring through SUGAT, if audited financial statements are not available in the future.

<u>Note 3 – Cash, cash equivalents and short-term investments</u>	<u>$85,851</u>
<u>Advance premium</u>	<u>$ 0</u>
<u>Premiums and considerations: Uncollected premiums and agents' balances in the course of collection</u>	<u>$25,363</u>

The above captioned amounts are the same as reported by the Company in its 2006 Annual Statement.

<u>Issue 1</u>

The issue relates to the accounts "Cash, cash equivalents and short-term investments" and "Advance premium." In reviewing the cash reconciliation for the Whitney Money Market Account reconciliation for December 2006, it was determined that premiums received in December 2006 that were not due until early 2007, in the amount of $46,800, were deposited in the Money Market Account in December 2006, but were not posted to the general journal until they were due in 2007. These premiums received in advance should have been accounted for on the balance sheet of the Annual Statement as an advanced premium when received to be in compliance with SSAP No. 53, paragraph 13 of the NAIC <u>Accounting Practices and Procedures Manual</u>, which states: "Advance premiums result when the policies have been processed, and the premium has been paid prior to the effective date. These advance premiums are reported as a liability in the statutory financial statement and not considered income until due. Such amounts are not included in written premium or the unearned premium reserve." The Company did not record the receipt of cash in connection with the transactions either. It was determined that surplus was not affected because the Company did not record the general journal entry and there was no entry for both an asset and a liability when the money was deposited in 2006. Had there been entries for the advance premiums and the receipt of cash, the asset and liability amount would be a wash and surplus would not have been affected. Since the discrepancy was due to improper accounting for premiums received before the due date, and the change does not affect surplus, the financial statements were not changed for this issue.

Issue 2

The issue relates to the accounts "Cash, cash equivalents and short-term investments" and "Premiums and considerations: Uncollected premiums and agents' balances in the course of collection." The examination indicated that $220,862 of the amount reported by the Company in its 2006 Annual Statement as "Cash, cash equivalents and short-term investments" was actually comprised of receivables due from agents at December 31, 2006. The receivables were collected from the agents on January 2 through January 4, 2007. The receivables should have been reported as "Premiums and considerations: Uncollected premiums and agents' balances in the course of collection" in accordance with the NAIC Annual Statement Instructions. The misclassification has no effect upon the Company's surplus as of year-end 2006. Due to the fact that the Company's surplus was not impacted, no changes were made to correct the misclassification in the financial statements included in this report.

Issue 3

The issue relates to the account "Cash, cash equivalents, and short-term investments." In the previous examination it was recommended that the Company ensure that the collateral pledged for the repurchase agreement meet the requirements of SSAP No. 45, paragraph 8 of the NAIC Accounting Practices and Procedures Manual by equaling 102 percent of the purchase price of the underlying security. The review of the repurchase agreement indicated that the agreement did not include the requirement that the collateral pledged under the repurchase agreement be at least equal to 102 percent of the purchase price of the underlying security.

Issue 4

The issue relates to the account "Cash, cash equivalents, and short-term investments." The disclosure for repurchase agreements included under Note 5.E. of the Notes to Financial Statements in the 2006 Annual Statement disclosed that there were not any repurchase agreements. It was determined that the Company had one repurchase agreement during 2006 which should have been disclosed to be in compliance with paragraph 18 of SSAP No. 45 of the NAIC Accounting Practices and Procedures Manual, which states, "The following disclosures shall be made in the financial statements: a. If the reporting entity has entered into repurchase agreements, its policy for requiring collateral or other security... "

Note 4 – Premiums and considerations: Deferred premiums, agents' balances and installments booked but deferred and not yet due — $7,519,014

The above captioned amount is $176,294 less than the $7,695,308 reported by the Company in its 2006.

The examination indicated that the Company reported admitted balances for "Premiums and considerations: Deferred premiums, agents' balances and installments booked but deferred and not yet due" for balances due the Company that exceeded the unearned premium reserve in connection with the respective balance. The examination indicated that some of the balances included were cancelled policies in which there were no unearned premium reserves in connection with the respective policy on the reporting date. SSAP No. 6, paragraph 9.b.ii. of the NAIC Accounting Practices and Procedures Manual, states, "If the bills receivable balance due exceeds the unearned premium on the policy for which the note was accepted, the amount in excess of the unearned premium is non-admitted." The change reflected above is the sum of the premium balances receivable that exceeded the respective unearned premium reserves.

Note 5 – Current federal and foreign income tax recoverable and interest thereon **$552,213**

The above captioned amount is the same as the amount reported by the Company in its 2006 Annual Statement.

The examination indicated that the money owed to the Company by Kingsway U. S. Finance Partnership as a result of losses or tax credits, was not returned to the Company by the upstream affiliate within thirty days in accordance with the Tax Allocation Agreement. The balance was settled in 41 days.

The examination indicated that the 2006 federal income tax return was not maintained in the Company's principal office in the State of Alabama, as required by ALA. CODE §27-27-29(a)(1975), which states, "Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions and affairs . . ."

Note 6 – Electronic data processing equipment and software **$162,235**

The above captioned amount is the same as reported by the Company in its 2006 Annual Statement.

The Company included nonoperating system software of $67,000 in the admitted assets column of "Electronic data processing equipment and software." This asset should have been nonadmitted in accordance with SSAP No. 16, paragraph 2 which states nonoperating system software are nonadmitted assets. This error resulted in an overstatement of the Company's admitted asset of $67,000 in its 2006 Annual Statement. Because the amount of overstatement was immaterial, no changes were made to the financial statements included in this report.

Note 7 – Receivables from parent, subsidiaries and affiliates **$378,073**

The above captioned amount is $480,921 less than the $858,994 reported by the Company in its 2006 Annual Statement.

As a result of the 2006 CPA audit, management determined that it was appropriate to write-off uncollectible receivables from its affiliates of $480,921. The aforesaid balances were written off during the first quarter of 2007. The balances were $212,949 due the Company from Southern United Holding, the Company's sole owner, and $267,972 due the Company from Southern United General Agency of Texas, the Company's wholly owned subsidiary.

SSAP No. 5, paragraph 7 states,

> An estimated loss from a loss contingency or the impairment of an asset shall be recorded by a charge to operations if both of the following conditions are met: a. Information available prior to issuance of the statutory financial statements indicates that it is probable that an asset has been impaired or a liability has been incurred at the date of the statutory financial statements. It is implicit in this condition that it is probable that one or more future events will occur confirming the fact of the loss or incurrence of a liability; and b. The amount of loss can be reasonably estimated.

Note 8 – Losses	$2,904,014
Loss adjustment expenses	$ 1,644,996

The above captioned amounts are the same as reported by the Company in its 2006 Annual Statement.

Issue 1

The Company erroneously allocated loss payments for surety losses incurred in 1996 of approximately $154,000 and payments for surety loss adjustment expenses for claims incurred in 1996 of approximately $3,000 to the 1997 accident year in the Company's 2006 Annual Statement Schedule P. The total of the loss payments was correct, but was not correctly allocated per the correct accident year as required by the NAIC Annual Statement Instructions. Because the examination findings had no impact on the 2006 financial statements, no adjustment to the financial statements included in this report is necessary for this issue.

Issue 2

The Company's detail of the 2002 loss and loss adjustment expense payments did not reconcile to the cumulative loss and loss adjustment expense totals reported in Schedule P. The person responsible for preparing Schedule P indicated that he did not prepare the 2001 Schedule P, but the 2001 Schedule P included errors in the cumulative accident year totals and adjustments had to be made in the 2002 Schedule P to accurately report the paid losses and paid loss adjustment expenses. Because the examination findings had no impact on the 2006 financial statements, there were no changes made in the financial statements included in this report for this issue.

Issue 3

The Company provided a detail of paid losses that included $7,378 of 2005 loss and loss adjustment expense payments from its surety line of business. The Company erroneously excluded $7,378 of 2005 loss and loss adjustment expense payments from its surety line of business in its 2005 Annual Statement Schedule P. The exclusions were not material and there were no changes made in the financial statements included in this report for this issue.

Issue 4

The 2005 loss payments allocated to accident year 1997 in the 2005 Schedule P did not reconcile to the detail of the same provided by the Company. The examiners noted a discrepancy of $14,000 in the examiners' reconciliation of the paid losses data to the Company's filed 2005 Annual Statement Schedule P. The Company responded to the examiner's inquiry to provide an explanation that a decision was made in 2005 to make adjustments for incorrect cumulative totals that had been carried forward from year to year in Schedule P. The adjustments made were not material. Because the examination findings had no impact on the 2006 financial statements, no changes were made in the financial statements included in this report for this issue.

Issue 5

The examiners attempted to reconcile the detail of the 2003 paid losses to the 2003 Annual Statement Schedule P Part 1. The paid losses detail data did not reconcile with the cumulative totals included within the paid losses cells allocated by accident year. The Company's in house actuary provided an explanation indicating that the Company made some corrections in the 2003 Schedule P cells allocating the loss payments by accident year due to errors in the cumulative year-end totals of paid losses per accident year at year-end 2003. When comparing the detail of 2003 paid losses and paid loss adjustment expenses allocated by accident year to Schedule P, the following material variances were noted: (1) The detail of the 2003 paid losses net of salvage and subrogation was $1,253,000 less than the amount reflected by the Company in its 2003 Schedule P, and there were material differences in the allocation by accident years for years 1999 through 2002; (2) The detail of the 2003 paid defense and cost containment loss adjustment expenses was $132,000 less than the same reflected in the 2003 Annual Statement Schedule P and there were material differences in the allocation by accident years 2000 through 2002. Because the examination findings had no impact on the 2006 financial statements, there were no changes made in the financial statements included in this report for this issue.

Note 9 - Commissions payable, contingent commissions and other similar charges	$ 448,581
Other expenses	$ 402,027
Ceded reinsurance premiums payable	$ 0

The above captioned amounts are the same as reported by the Company in its 2006 Annual Statement.

Issue 1 relates to "Ceded reinsurance premiums payable" and "Other expenses." Issue 2 relates to "Other expenses" and "Commissions payable, contingent commissions and other similar charges." Issue 3 relates to "Other expenses" only.

Issue 1

The Company incorrectly included a reinsurance item in the amount of $29,363 in the "Other expenses" Annual Statement line item. This was a reinstatement premium required as a result of hurricane Katrina and should have been included in the line item "Ceded reinsurance premiums payable." According to the NAIC Annual Statement Instructions, "reinsurance premiums associated with those in course of payment, premium installments booked but deferred and not yet due, and accrued retrospective ceded premiums" should be included in "Ceded Reinsurance Premiums Payable." There were no changes made to the financial statements included in this report due to the misclassification having no effect on the Company's surplus.

Issue 2

It was determined that the Company included $120,847 in payables to finance companies that finance premiums of the Company's insureds in the account "Commissions payable, contingent commissions and other similar charges" of the 2006 Annual Statement. This payable should have been included in the account "Other expenses" to be in compliance with the the NAIC Annual Statement Instructions, which states "Line 5 - Other Expenses Include: Incurred but unpaid other underwriting and investment expenses, excluding taxes, licenses and fees." The misclassification had no effect on the Company's surplus. No changes were made to the financial statements included in this report for this issue.

Issue 3

The Company did not make an accrual for the payroll due to its employees at year end in the amount of $73,311. This should have been included within the Annual Statement line item "Other expenses." According to the NAIC Annual Statement Instructions, "Other Expenses" should include "Incurred but unpaid other underwriting and investments expenses, excluding taxes, licenses, and fees." Due to the understatement being immaterial, there were no changes made in the financial statements for this issue.

Note 10 – Amounts withheld or retained by company for account of others **$143,471**

The above captioned amount is the same as reported by the Company in its 2006 Annual Statement.

The examination indicated that $67,980 of the $143,471 reported in the Company's 2006 Annual Statement consisted of obligations of Consolidated Insurance Management Corporation (CIMC), an affiliate of the Company. CIMC has been dissolved. Southern United Holding (SUH) is CIMC's successor. The correct amount that should have been reported was $75,490 in accordance with the NAIC Annual Statement Instructions. The amount was determined to be immaterial and no changes were required to be made to the 2006 financial statement. The examiners verified that the balance due in connection with the CIMC balance was settled in 2007 by SUH.

Note 11 – Premium deficiency reserves — **$962,223**

The above captioned amount is $962,223 more than the $0 reported by the Company in its 2006 Annual Statement.

The Company did not correctly evaluate premium deficiency reserves in a manner consistent with their reinsurance treatment. When reinsurance accounting was applied to the quota share treaty with Kingsway Reinsurance Corporation, there was a resulting deficiency in booked net unearned premium reserves as of December 31, 2006. The actuarial examiner calculated the premium deficiency reserves to be $962,223.

Note 12 – Change in surplus notes — **$(2,921,250)**
Surplus adjustments: Paid in — **$ 2,921,250**

The above captioned amount for "Change in surplus notes" is $2,921,250 less than the $0 reported by the Company in its 2006 Annual Statement. The above captioned amount for "Surplus adjustments: Paid in" is $2,921,250 more than the $0 reported by the Company in its 2006 Annual Statement.

The holder of the surplus note forgave the Company's indebtedness during 2006. It was determined that the Company omitted in its 2006 Annual Statement, the amount for change in surplus notes in the surplus reconciliation of the 2006 Annual Statement.

Note 13 – Unassigned funds — **$(27,672,417)**

The above captioned amount is $1,619,438 less than the $(26,052,979) reported by the Company in its 2006 Annual Statement. The following is a reconciliation of Unassigned funds per this examination.

Unassigned funds per Company	$(26,052,979)
Examination increase/(decrease) to assets:	
Premiums and considerations: Deferred premiums, agents' balances and installments booked but deferred and not yet due	(176,294)
Receivables from parent, subsidiaries and affiliates	(480,921)
Examination decrease/(increase) to liabilities:	
Premium deficiency reserves	(962,223)
Total Unassigned funds per examination	$(27,672,417)

COMMENTS AND RECOMMENDATIONS

Management and Service Agreements – Page 6

It is recommended that the Company comply with all of the terms of its agreements with affiliates and not make advances for services to be provided when the agreement stipulates differently.

Conflicts of Interest – Page 9

It is recommended that the Company require each of its officers and directors to file completed, signed, and dated conflict of interest statements, electronically or written, on an annual basis in order for the Company to ensure compliance with the Company's policies relating to conflicts of interests.

Corporate Records – Page 10

It is recommended that the Company implement procedures to ensure that the Company complies with Section 1033 of Title 18 of the United States Code, which prohibits the Company from having employees, producers, insurance agencies, consultants, third party administrators, MGA's ,subcontractors, or an agency who has been convicted of a felony involving dishonesty or a breach of trust unless the prohibited person has obtained permission to serve in their capacity by the Commissioner.

Compliance with Agents' Licensing Requirements – Page 17

It is recommended that the Company ensure that all of its agents are properly licensed and not pay commissions to agents that are not licensed.

It is recommended that the Company monitor on a regular basis the termination of producers and send proper notification to the producers and the Alabama Department of Insurance in accordance with ALA. CODE §27-7-30.1(a)(1975), which requires,

> Within 15 days after making the notification required by subsection (e) of Section 27-7-30, the insurer shall mail a copy of the notification to the producer at his or her last known address. If the producer is terminated for cause for any of the reasons listed in Section 27-7-19, the insurer shall provide a copy of the notification to the producer at his or her last known address by certified mail, return receipt requested, postage prepaid or by overnight delivery using a nationally recognized carrier.

and ALA. CODE §27-7-30(e)(1975), which requires,

> Subject to the producer's contract rights, if any, an insurer or authorized representative of the insurer may terminate a producer's appointment at any time. An insurer or authorized representative of the insurer that terminates the appointment, employment, or contract with a producer for any reason shall within

> 30 days following the effective date of the termination, using a format prescribed by the commissioner, give notice of the termination to the commissioner.

<u>Reinsurance - Page 18</u>

It is recommended that the Company provide the required prior notification to the Commissioner of the Company's intentions to amend reinsurance agreements with affiliates in accordance with ALA. CODE §27-29-5(b)(1975), which states,

> The following transactions involving a domestic insurer and any person in its holding company system may not be entered into unless the insurer has notified the commissioner in writing of its intention to enter into such transaction at least thirty days prior thereto, or such shorter period as the commissioner may permit, and the commissioner has not disapproved it in that period... (3) Reinsurance agreements or modifications thereto in which the reinsurance premium or a change in the insurer's liabilities equals or exceeds five percent of the insurer's surplus as regards policyholders, as of the 31st day of December next preceding, including those agreements which may require as consideration the transfer of assets from an insurer to a nonaffiliated, if an agreement or understanding exists between the insurer and nonaffiliate that any portion of assets will be transferred to one or more affiliates of the insurer.

It is recommended that the Company correctly apply the terms of their reinsurance agreement, or amend the agreement to correctly reflect the intent of the companies.

<u>Accounts and Records - Page 21</u>

It is recommended that the Company maintain complete claim files at its home office in accordance with ALA. CODE §27-27-29(a)(1975), which states in part, "Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of insurance transacted."

It is recommended that the Company complete its Underwriting & Investment Exhibit Part 3 - Expenses in accordance with the <u>NAIC Annual Statement Instructions</u>.

It is recommended that the Company implement a formal record retention policy in compliance with ALA. ADMIN. CODE 482-1-118-.03(2002), which requires,

> Records Required for Purposes of Financial Examinations. Every insurer, which term shall include every domestic insurer, foreign insurer, health care services corporation, health maintenance organization, prepaid dental plan, managing general agent or any other legal entity regulated by the Insurance Code and licensed to do business in this state shall maintain its books, records, documents and other business records in order that the insurer's financial condition may be readily ascertained by

the Department of Insurance, taking into consideration other record retention requirements. All records must be maintained for not less than five (5) years.

It is recommended that the Company develop a long-term strategic plan and review the plan on a periodic basis to make any adjustments that may become necessary.

It is recommended that the Company report its management fees and information systems fees paid in the Underwriting & Investment Exhibit Part 3 Expenses in a manner which allocates the expenses to the appropriate expense classification items in accordance with the NAIC Annual Statement Instructions, which state,

> A Company that pays any affiliated entity (including a managing general agent) for the management, administration, or service of all or part of its business or operations shall allocate these costs to the appropriate expense, classification items (salaries, rent, postage, etc.) as if the costs had been borne directly by the company. Management, administration, or similar fees should not be reported as a one-line expense. The company may estimate these expense allocations based on a formula or other reasonable basis.

Bonds - Page 28

It is recommended that the Company review prepayment assumptions of mortgage backed securities at least as often as on a quarterly basis in accordance with SSAP No. 43, paragraph 11, which states, in part, "Changes in currently estimated cash flows, including the effect of prepayment assumptions, on loan-backed securities shall be reviewed periodically. For securities that have the potential for loss of a portion of the original investment, the review shall be performed at least quarterly."

It is recommended that the Company accurately amortize its bonds utilizing the scientific interest method in accordance with SSAP No. 26 which states, "Amortization of bond premium or discount shall be calculated using the scientific interest method taking into consideration specified interest and principal provisions over the life of the bond. Bonds containing call provisions shall be amortized to the call or maturity value/date which produces the lowest asset value."

Common Stocks - Page 28

It is recommended that the Company obtain audited financial statements for its subsidiary in order that the true equity value of the SCA investment can be verified by the Alabama Department of Insurance. It is noted that SUGAT is potentially subject to future audit by the Alabama Department of Insurance in order to determine the true financial position of SUGAT and to determine the nature and extent of transactions occurring through SUGAT, if audited financial statements are not available in the future.

Cash, cash equivalents and short-term investments; Premiums and considerations: Uncollected premiums and agents' balances in the course of collection; Advance premium - Page 29

It is recommended that the Company account for premiums that are received in advance as "Advanced premium" on the balance sheet of the Annual Statement in compliance with SSAP No. 53, paragraph 13, "Advance premiums result when the policies have been processed, and the premium has been paid prior to the effective date. These advance premiums are reported as a liability in the statutory financial statement and not considered income until due. Such amounts are not included in written premium or the unearned premium reserve."

It is recommended that the Company properly report its receivables from agents as "Premiums and considerations: Uncollected premiums and agents' balances in the course of collection" in accordance with the NAIC Annual Statement Instructions. The examination indicated that some of the receivables were reported as "Cash, cash equivalents and short-term investments" in the 2006 Annual Statement.

It is recommended that repurchase agreements comply with SSAP No. 45, paragraph 8, which states: "The collateral requirements for repurchase and reverse repurchase agreements are as follows: Repurchase Transactions a. The reporting entity shall receive as collateral transferred securities having a fair value at least equal to 102 percent of the purchase price paid by the reporting entity for the securities... "

It is recommended that the Company properly disclose the repurchase agreements it is a party to, and its policy for requiring collateral or other securities for the repurchase agreement, in Note 5.E. of the Notes To Financial Statements in the Company's Annual Statements, to be in compliance with Paragraph 18, of SSAP No. 45, which states: "The following disclosures shall be made in the financial statements: a. If the reporting entity has entered into repurchase agreements, its policy for requiring collateral or other security... "

Premiums and considerations: Deferred premiums, agents' balances and installments booked but deferred and not yet due - Page 30

It is recommended that the Company not admit "Premiums and considerations: Deferred premiums, agents' balances and installments booked but deferred and not yet due" that exceed the unearned premium reserves in connection with the balance in accordance with SSAP No. 6, paragraph 9.b.ii. of the NAIC Accounting Practices and Procedures Manual, which states, "If the bills receivable balance due exceeds the unearned premium on the policy for which the note was accepted, the amount in excess of the unearned premium is non-admitted."

Current federal and foreign income tax recoverable and interest thereon - Page 31

It is recommended that the Company comply with all aspects of its Tax Allocation Agreement and collect money owed to the Company in accordance with said agreement.

It is recommended that the Company comply with ALA. CODE §27-27-29(a)(1975), which states, "Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions and affairs . . . ."

Electronic data processing equipment and software - Page 31

It is recommended that the Company exclude nonoperating system software from admitted assets reported in "Electronic data processing equipment and software" in accordance with SSAP No. 16, paragraph 2.

Receivables from parent, subsidiaries and affiliates - Page 31

It is recommended that the Company not admit uncollectible receivables from affiliates in accordance with SSAP No. 5, paragraph 7, which states

> An estimated loss from a loss contingency or the impairment of an asset shall be recorded by a charge to operations if both of the following conditions are met: a. Information available prior to issuance of the statutory financial statements indicates that it is probable that an asset has been impaired or a liability has been incurred at the date of the statutory financial statements. It is implicit in this condition that it is probable that one or more future events will occur confirming the fact of the loss or incurrence of a liability; and b. The amount of loss can be reasonably estimated.

Losses; Loss adjustment expenses - Page 32

It is recommended that the Company accurately report the cumulative paid losses totals allocated by accident year in the Annual Statement Schedule P in accordance with the NAIC Annual Statement Instructions.

Commissions payable, contingent commissions and other similar charges; Other expenses; Ceded reinsurance premiums payable - Page 33

It is recommended that the Company include reinsurance reinstatement premium liabilities within the Annual Statement line item "Ceded reinsurance premiums payable" consistent with the NAIC Annual Statement Instructions which states to include the following for the aforesaid line item, "Include: Reinsurance premiums associated with those in course of payment, premium installments booked but deferred and not yet due, and accrued retrospective ceded premiums."

It is recommended that the Company include the payables to finance companies that finance premiums of the Company's insureds in the line item "Other expenses" in accordance with the NAIC Annual Statement Instructions, which states: "Line 5 - Other Expenses Include: Incurred but unpaid other underwriting and investment expenses, excluding taxes, licenses and fees."

It is recommended that the Company include its payroll accrual liability within the Annual Statement line item "Other expenses" consistent with NAIC Annual Statement Instructions which states the following to be included in the aforesaid line item, "Include: Incurred but unpaid other underwriting and investments expenses, excluding taxes, licenses, and fees."

Amounts withheld or retained by company for account of others - Page 34

It is recommended that the Company only include financial obligations of the Company and not financial obligations of its affiliates in the account "Amounts withheld or retained by company for account of others."

Premium deficiency reserves - Page 35

It is recommended that the Company establish procedures to evaluate premium deficiency reserves in connection with the preparation of financial statements. Premium deficiency reserves are addressed in SSAP No. 53, paragraphs 15 and 16.

It is recommended that the Company properly record any required premium deficiency reserves.

Change in surplus notes - Page 35

It is recommended that the Company correctly complete the surplus account reconciliation in the Annual Statement.

Compliance with Previous Recommendations - Page 41

It is recommended that the Company comply with the recommendations of the Report of Examination.

CONTINGENT LIABILITIES AND PENDING LITIGATION

The review of the commitments and contingent liabilities included an inspection of representations made by management, consideration of the CPAs work performed with respect to testing unreported contingent liabilities, and a review of the Company's transactions subsequent to the examination date. The review did not indicate any contingent liabilities as of December 31, 2006. Company management represented that no material non-policy related litigation was open against the Company as of April 1, 2008. Company management did not subsequently disclose any material pending litigation in the letter of representation provided to the examiners bearing the same date as this report.

COMPLIANCE WITH PREVIOUS RECOMMENDATIONS

The previous Report of Examination included a recommendation for the Company to keep a record of notifications that were mailed to the Alabama Department of Insurance and letters of termination mailed to the agents in accordance with ALA CODE §27-27-29(a)(1975). The examination indicated that two of 47 notifications that were required to be sent to the Alabama Department of Insurance that were requested by the examiners could not be provided by the Company, and 16 of the 47 letters of notification of terminations to agents that were required to be mailed to the agents could not be provided. ALA. CODE §27-27-29(a)(1975) requires, "Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of insurance transacted." Further discussion of the termination notices that could not be provided is included in this report under the caption "COMPLIANCE WITH AGENTS' LICENSING REQUIREMENTS."

In the previous Report of Examination, it was recommended that the Company ensure that the collateral pledged for the Company's repurchase agreement equal to 102 percent of the purchase price of the underlying security. In a review of the repurchase agreement between the Company and Whitney Bank as of December 31, 2006, it was determined that there was no mention of the amount of collateral required under repurchase transactions. The Company did not comply with the recommendation of the previous Report of Examination. Further discussion of the Company's repurchase agreement with Whitney Bank can be found in this report under the caption "NOTES TO FINANCIAL STATEMENTS."

The previous Report of Examination recommended that the Company comply with ALA. CODE §27-27-29(a)(1975), and maintain all records pertaining to the Company's operations at its home office within the State of Alabama. The examination indicated that the Company was not retaining its complete claim files at it home office for claims that were being processed by the third party administrator in Arizona. The Company did not retain a copy of its 2006 federal income tax return at the home office. The Company did not comply with the recommendation.

The prior Report of Examination recommended that the Company comply with all aspects of its Tax Allocation Agreement and collect money owed to the Company in accordance with said agreement. Balances due the Company were not settled within thirty days as stipulated by the agreement. The Company did not comply with the recommendation. Further discussion of the issue is included in this report under the caption "NOTES TO FINANCIAL STATEMENTS."

The prior Report of Examination included a recommendation for the Company to calculate its contingent liability relating to the sliding scale commission arrangements in its reinsurance contracts by treaty and by agreement year in order to ensure that the results by agreement years do not affect the terms of other agreement years. The examination indicated that the Company did not comply with the recommendation. Further discussion of errors in connection with the calculation of the ceded reinsurance commissions is included in this report under the caption "REINSURANCE."

SUBSEQUENT EVENTS

The examiners reviewed the general ledger and cash transactions subsequent to December 31, 2006. The examiners inquired of management of significant events subsequent to the examination date. The following significant events warrant disclosure.

At the April 24, 2007 Board of Director's meeting, the resignation of the Company President, Richard Murray, and Vice President and Secretary, Richard Bird, were accepted. At that time, new officers were appointed as follows.

President – William Gabriel Star
Treasurer – Carrie Renee Harper
Secretary – Leslie Patterson DiMaggio

Effective December 31, 2007, the President, William Star, resigned. William Star and Richard Murray resigned from the Board of Directors since December 31, 2006. The Company's officers as of the date of this report are as follows.

President – Leslie DiMaggio
Vice President/Secretary/Treasurer – Carrie Harper
Vice President – Gordon Setters
Vice President – Therese' Morris
Vice President – Christine Chapman

The July 23, 2007 Board of Directors meeting disclosed that the Company changed its method for determining IBNR loss reserves from the Link Ratio Method to the Bornhuetter/Ferguson Method. According to the minutes, the change of methodology was made in June of 2007, and resulted in a decrease of the IBNR loss reserves of approximately $2 million dollars.

The Company entered into a Services Agreement with American Country Insurance Company (ACIC) effective January 1, 2007. ACIC agreed to manage a commercial automobile program for the Company. ACIC will provide the Company with accounting, actuarial, underwriting, and claims management services with respect to the commercial automobile program. ACIC will provide the Company audit services including claims, underwriting, systems, accounting and other reviews as deemed necessary by ACIC. The Company will compute and remit premium tax payments to each jurisdiction. The compensation that the Company will pay to ACIC was identified as follows. The Company will pay a fee for services which shall be computed based upon the operating results of the Commercial Automobile Program. The agreement identifies the calculation of the operating results as earned premium less the sum of net losses incurred, loss adjustment expenses incurred, commissions earned by agents, external reinsurance, administrative expenses and acquisition costs. If the operating result is a loss, ACIC will owe the amount of the loss to the Company. The Company had amended the terms of the agreement with Addendum No. 1 to the agreement. As of the date of this report, the Alabama Department of Insurance has not approved Addendum No. 1 amending the terms of the agreement.

The Company received a letter dated December 5, 2007, from the State of South Carolina notifying it that it must post a statutory deposit of $5 million or receive a $5 million capital contribution from its parent company, or the Company's direct writings in South Carolina would be restricted. The Company asked the regulator to reconsider the request. The regulator agreed not to restrict the direct writings in South Carolina even though a capital contribution was not received or a statutory deposit was not pledged, but the regulator reserved the right to reconsider the decision after reviewing the Company's 2007 Annual Statement.

During 2007, the Company received additional capital contributions from its parent, Southern United Holding, Inc. of $3 million and $1.5 million. The Company received a contribution of $750,000 from Kingsway America, Inc. on February 21, 2008.

CONCLUSION

Acknowledgement is hereby made of the courtesy and cooperation extended by all persons representing Southern United Fire Insurance Company during this examination.

The customary insurance examination procedures, as recommended by the National Association of Insurance Commissioners, have been followed in connection with the verification and valuation of assets and the determination of liabilities set forth in this report.

In addition to the undersigned, Theo Goodin, Jennifer Haskell, Michael Masuen, CFE, AES, CISA and Robert Thompson, Examiners; and Randall Ross, FCAS, MAAA, of Taylor-Walker & Associates, Consulting Actuary; all representing the Alabama Department of Insurance, participated in this examination of Southern United Fire Insurance Company.

Respectfully submitted,

Palmer W. Nelson, CFE
Examiner-in-charge
Alabama Department of Insurance
Southeastern Zone, NAIC